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# Criminal Investigation Enforcement Activities and Taxpayer Noncompliance

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# The Purpose of this Study

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- Determine whether CI activities have a measurable effect on voluntary compliance among individual taxpayers.
- Ascertain the effects of media attention and publicity on increasing individual tax compliance.
- Assess the impact of prison and probation sentencing on individual tax compliance.
- Analyze whether IRS resources are efficiently allocated to achieve optimal levels of individual tax compliance.

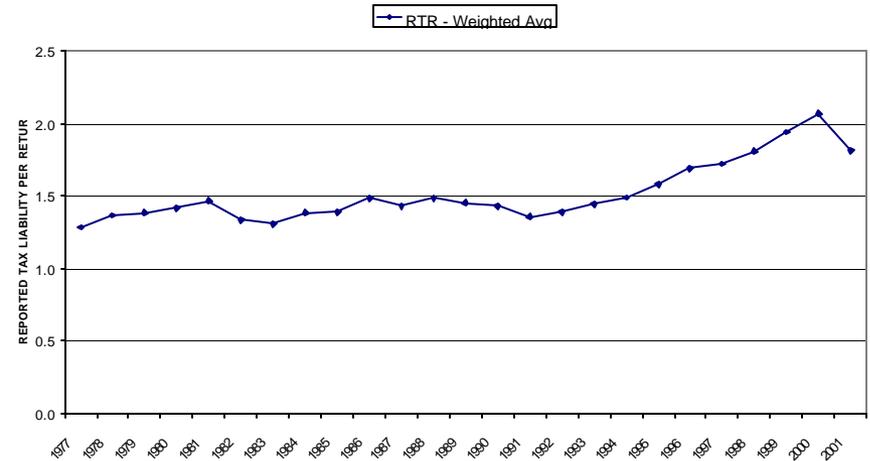
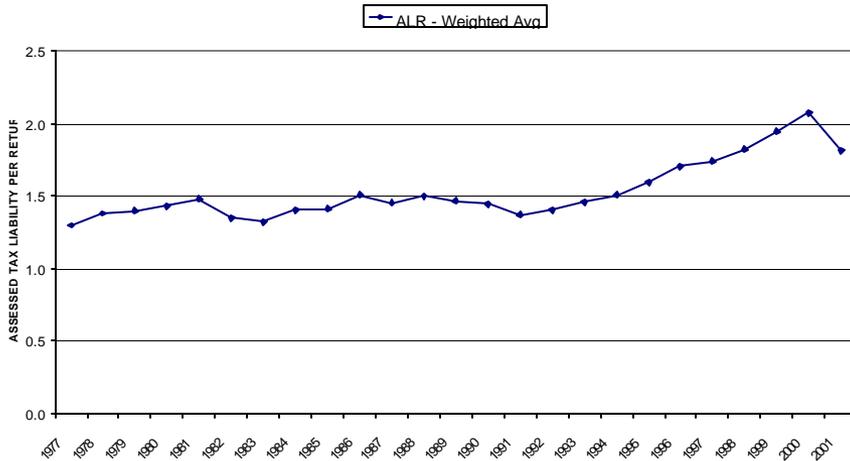
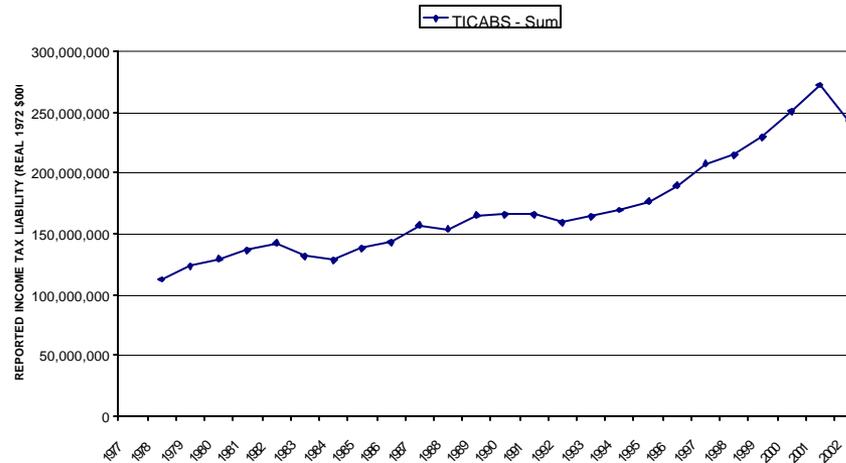
# Research Methodology

- The method was developed by Dubin, Graetz and Wilde in “The Effects of Audit Rates on the Federal Income Tax, 1977-1986” (1990).
- The 1990 analysis used a state-level cross-sectional time series dataset for the years 1977-1986. The new study uses data for the years 1988-2001.
- This method is based on two econometric models that simulate both specific and general deterrence effects associated with CI activities and audit rates.

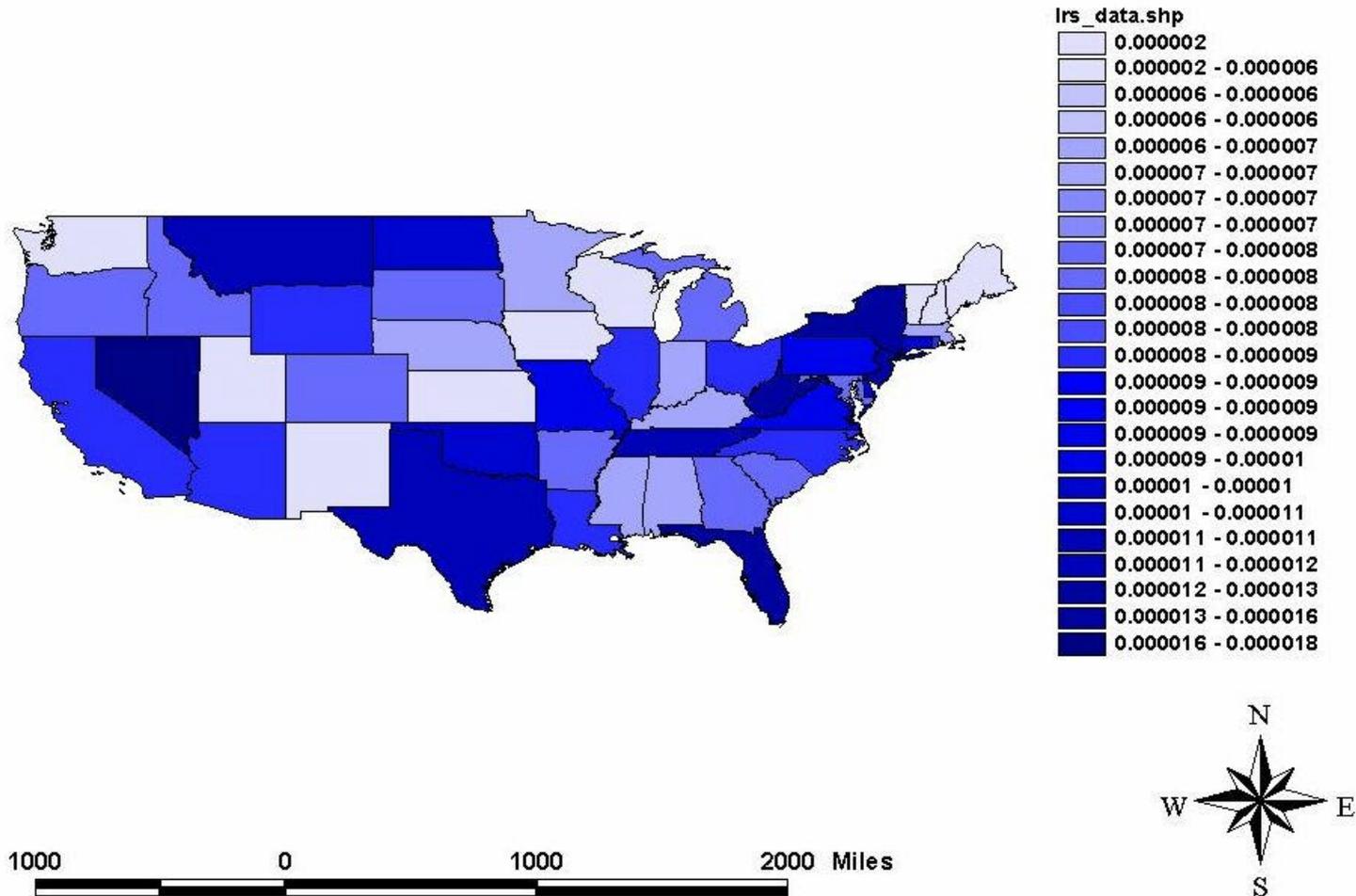
# Data Sources

- **Socioeconomic:** U.S. Census, Bureau of Labor Statistics, Bureau of Economic Analysis, U.S. Dept of Agriculture, U.S Dept of Health and Human Services
- **Political Science:** U.S. Congressional Almanac, [www.icpsr.umich.edu:8080/ICPSR-PRA/01208.xml](http://www.icpsr.umich.edu:8080/ICPSR-PRA/01208.xml)
- **Individual Returns, Collections and Examinations:** Annual Report of the Commissioner of Internal Revenue, IRS Data Book, “total exams by year state and organization.xls”, “total addl by year state and organization.xls” (files rec’d 7/30/03), IRS Statistics of Income Bulletin.
- **IRS Budget and Examination Time:** “det\_pct\_01\_03.xls”, “det\_pct\_97\_00.xls”, “det\_pct\_92\_96.xls”, “det\_pct\_79\_91.xls” (files rec’d 7/21/03), Annual Report of the Commissioner of Internal Revenue, IRS Data Book
- **Criminal Investigation:** “Sentences by State (sent vltn) FY88-02.xls” (file rec’d 7/24/03), “Pros by State FY88-02.xls” (file rec’d 7/21/03)

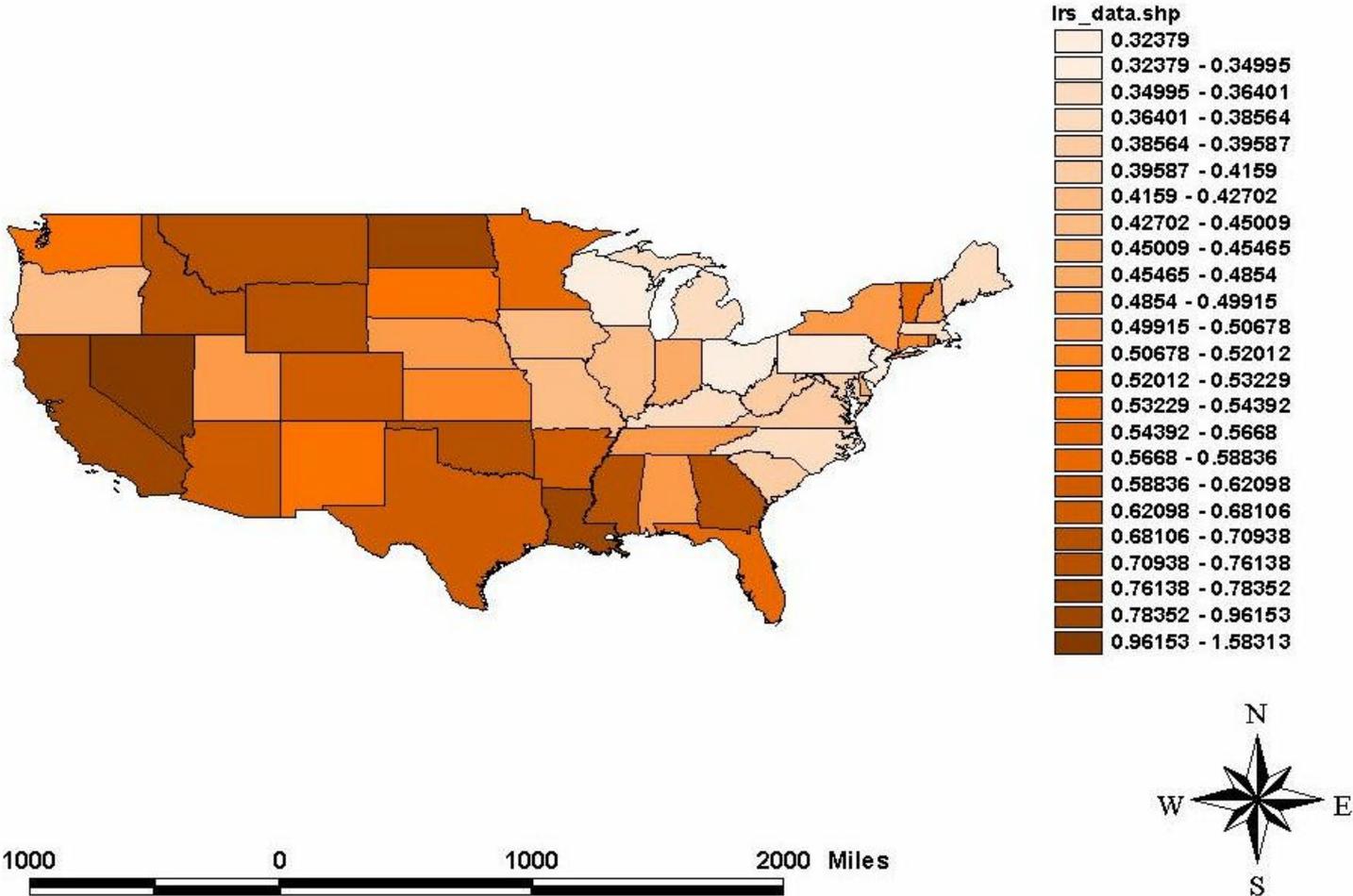
# Individual Collections Data



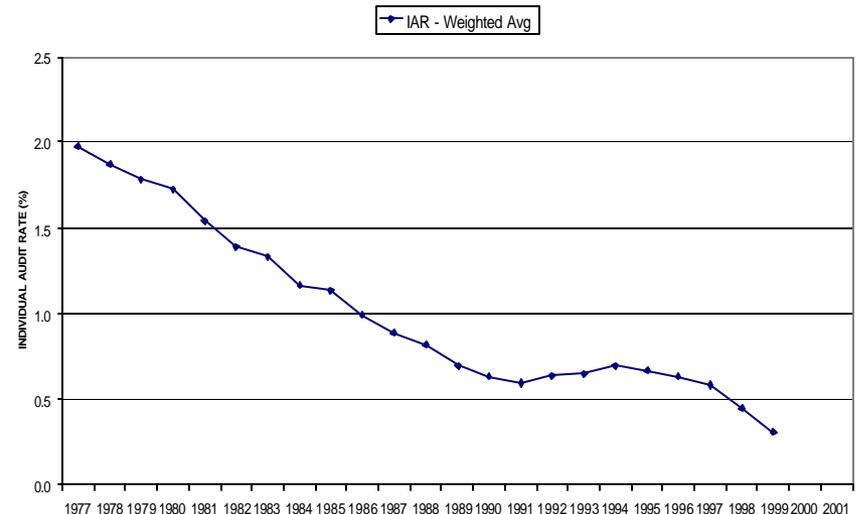
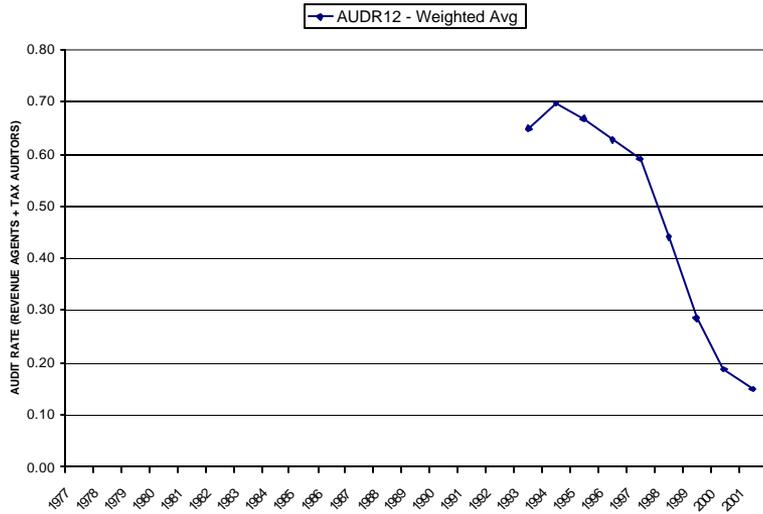
# Total CI Sentences Per Capita Among States (1999 Population)



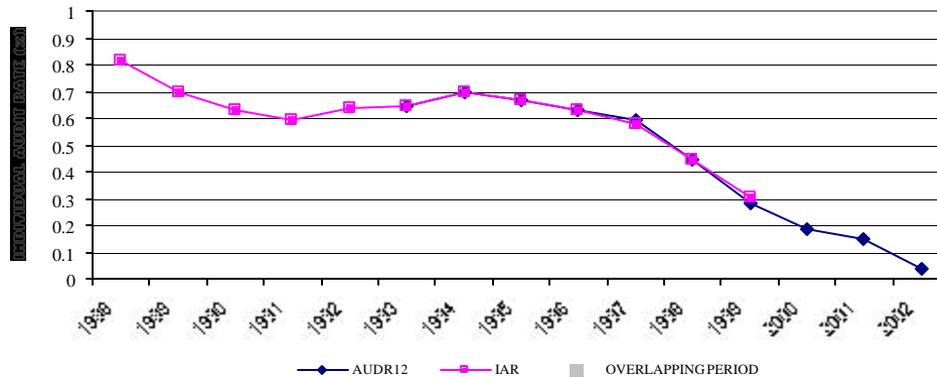
# Individual Audit Rate Among States



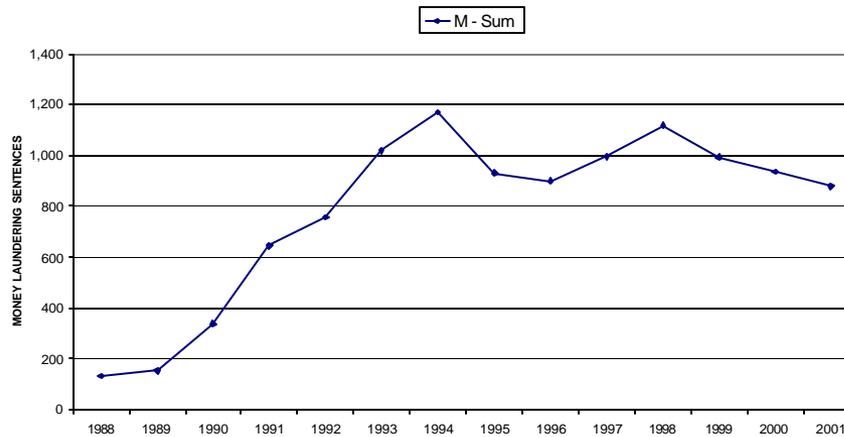
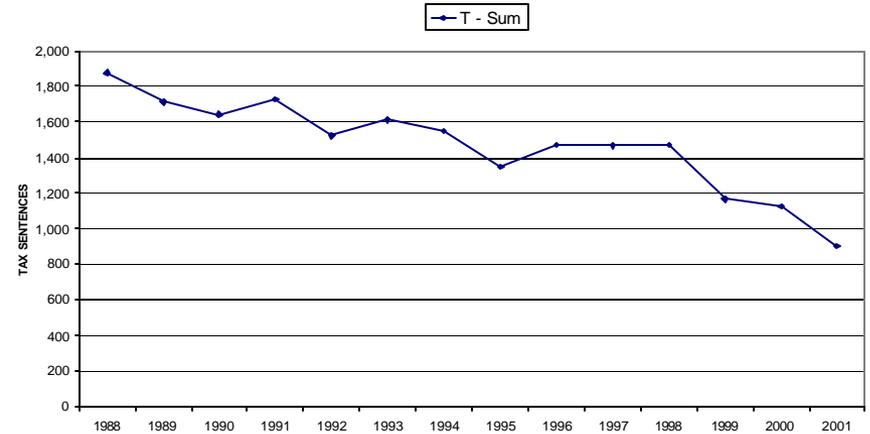
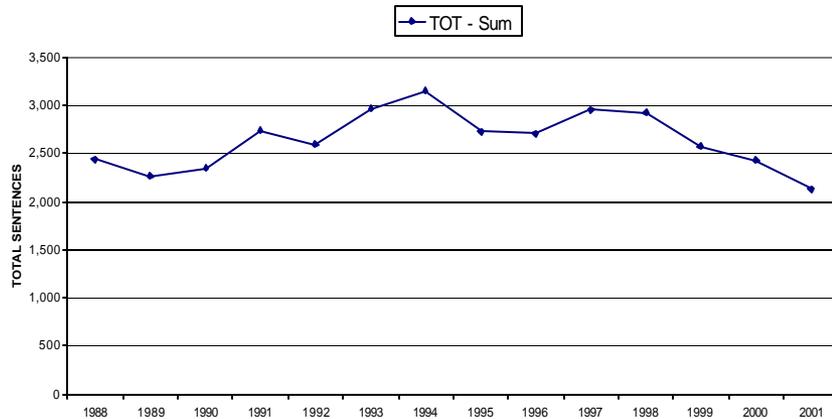
# Individual Audit Rate Data



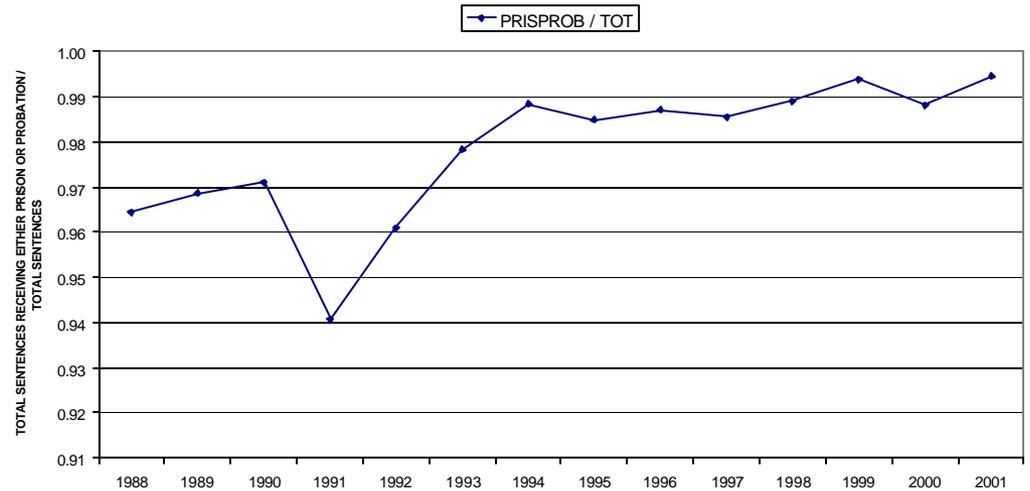
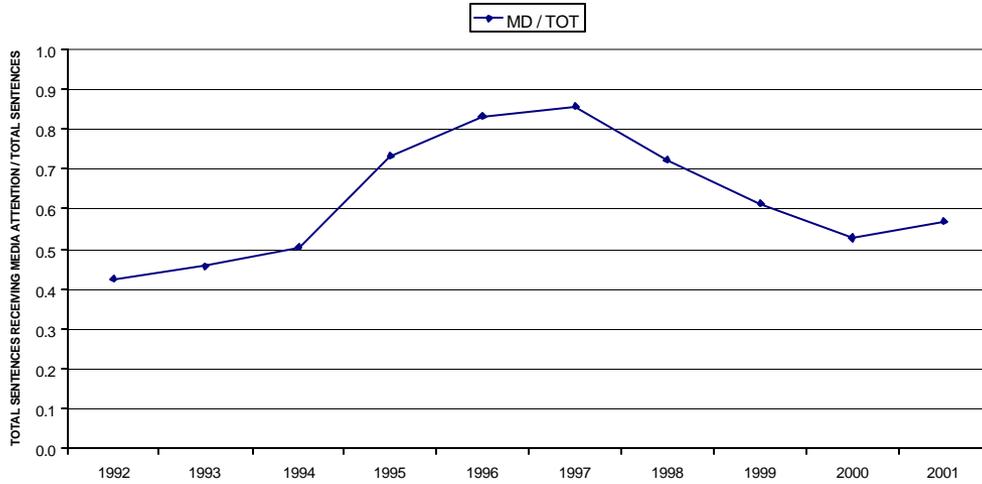
## AUDIT RATE COMPARISON



# Criminal Investigation Data



# Criminal Investigation Data (cont.)



# Results of Audit Experiments

- Audit rates have a significant effect in increasing tax compliance.
- Analysis of the post-1987 period demonstrates that higher audit rates lead to more returns being filed per capita contrary to the 1977-1986 analysis.
- There is no evidence, in our study, that correspondence audits have made up for the decline in face-to-face tax audits. This result may be due to the limited time period during which we were able to measure the correspondence audit rate.

# Results of CI Regressions

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- The total number of tax and money laundering sentences has a significantly positive effect on tax compliance.
- The mix of tax and money laundering sentences with respect to the total number of sentences does not have a significant impact on tax compliance. The mix may already be optimally set.
- A higher percentage of money laundering sentences that result in either prison or probation increases tax compliance.

# Simulation Methodology

- Calculate a predicted value for the increase in total assessed liability for a particular year that would have resulted from holding audit rates at their simulated levels. (Total Effect)
- Calculate the effect of this audit rate change on reported liabilities that exclude additional taxes and penalties resulting from IRS examinations. (Indirect Effect)
- The difference between the two estimates represents the direct effect of the increase in audit rates. (Direct Effect)
- DGW estimated that the spillover effects of audits produce six out of every seven dollars of additional revenue (roughly 86%).

# Results of Simulations

- Doubling the audit rate is forecast to increase assessed tax collections by \$18.7 billion in nominal terms.
- Doubling the total number of tax and money laundering sentences is forecast to increase assessed tax collections by \$16.7 billion in nominal terms.
- The spillover effects of doubling either the audit rate or CI activities are estimated at 94% of total effects.
- Doubling the audit rate or doubling the money laundering sentences produced similar increases in total collections and similar increases in general deterrence.
- The spillover effect of audits is quite large and generally estimated to be over 90 percent across a wide range of empirical specifications for the audit rate.

# Conclusions from Empirical Research

- Enforcement of federal tax laws through both audits and criminal investigations helped increase individual tax compliance during the time period from 1988 to 2001.
- An increase in IRS examination activity could have important fiscal impacts and make a large contribution toward reducing the tax gap.
- CI activities have a statistically significant measurable effect on voluntary compliance.
- Having a higher rate of sentences resulting in prison or probation for money laundering cases would help achieve higher levels of tax compliance.
- Changing the mix of tax and money laundering cases investigated would not have a pronounced impact on general deterrence.

# Conclusions from Empirical Research (cont.)

- Although media coverage has a statistically minimal effect on tax compliance, the significant effect that CI sentencing has on general deterrence demonstrates that the media serves an important function in spreading information to the public.
- Based on reported unit cost estimates, each additional dollar allocated to audit investigation would return \$58 in general deterrence, while each additional dollar allocated to CI activities would return \$66 in general deterrence, providing some evidence that the IRS should devote more resources to CI activity.
- An additional allocation of \$25 million a year to CI activities, which amounts to roughly 200 more cases a year or 250 additional agents, would increase general deterrence by almost \$1.7 billion.